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IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

No. 48.

MUNRO L. LYETH,

Petitioner,

v.

JAMES J. HOEY, Collector of Internal Revenue of the United States for the Second District of the State of New York,

Respondent.

BRIEF FOR PETITIONER.

J. M. RICHARDSON LYETH,
WILL R. GREGG,
ALLIN H. PIERCE,
Counsel for Petitioner.

THE COURT PRESS, N. Y. C.

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JAMES J. HOEY, Collector of Internal Revenue of the United States for the Second District of the State of New York, *Respondent.*

BRIEF FOR PETITIONER.

Opinions Below.

The opinion of the District Court by Judge Alfred C. Coxe (R. 112-117) is reported in 20 Fed. Supp. 619. The opinion of the Circuit Court of Appeals for the Second Circuit by Circuit Judge Chase (R. 124-129) and the concurring opinion by Circuit Judge Augustus N. Hand (R. 129-131) are reported in 96 Fed. (2d) 141.

Jurisdiction.

The order and mandate of the Circuit Court of Appeals was filed April 18, 1938 (R. 131-132). Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938.

Statement.

Petitioner sues to recover additional income taxes for the year 1933 paid pursuant to an additional assessment based upon the receipt by him from the executors of his grandmother's estate of certain property pursuant to an agreement compromising the objections to probate of her will. Petitioner's motion for summary judgment under Rule 113 of the New York Rules of Civil Practice was granted and judgment was entered against the respondent for $65,005.08 with interest and costs. The Circuit Court of Appeals for the Second Circuit reversed.

Petitioner is a grandson of Mary B. Longyear who died March 14, 1931, a resident of Massachusetts, leaving as her heirs four surviving children, and the petitioner and his brother, sons of a deceased daughter (R. 56). The estate was initially inventoried at more than $3,000,000. (R. 56). By her will the decedent bequeathed to each of her said heirs comparatively trifling legacies (R. 56). The entire residue, which was by far the greater part of the estate, was bequeathed to trustees of a so-called Endowment Trust under which the income was payable to another set of trustees under another trust referred to as Longyear Foundation (R. 58). The principal purpose of the latter trust was to preserve the records of the earthly life of Mary Baker Eddy, the founder of the Christian Science religion (R. 59, 70). Both of these trusts were revocable and subject to amendment by Mrs. Longyear by an instrument in writing, not testamentary in character; and in fact they were twice amended by her, once before the execution of the will (although the amendment was not referred to in her will) and once after such execution (R. 58, 59, 68, 73).

The heirs objected to the probate of the will upon the grounds, among others, of lack of testamentary capacity and undue influence. A motion was made on behalf of the heirs to frame jury issues which was granted after a hearing at which counsel for the proponents and counsel for the contestants stated what their proofs would be (R. 57). If there had been no compromise and the will had been probated after a trial of the contest, there would nevertheless have remained two legal questions: (1) Whether the residuary legacy was valid under the statute of wills, in that the testatrix reserved for herself the right to alter and amend the trust by an act not testamentary in character; *Atwood* v. *R. I. Hospital Trust Co.*, 275 Fed. 513 (C. C. A. 1, 1921), cert. den., 257 U. S. 661; *Olliffe* v. *Wells*, 130 Mass. 221 (1881); and (2) Whether the trusts were valid under the rule against perpetuities as charitable or religious trusts in that their purpose was not to promote the religion of Christian Science, but to preserve the records of the earthly life of its founder (R. 58, 59).

A compromise agreement dated April 26, 1932 was entered into and signed by the legatees, devisees, executors under the will, the heirs, and the Attorney General of Massachusetts (R. 15-32). That agreement provided in substance that the specific and pecuniary bequests to individuals be enforced, but that the bequest of the residuary estate to the alleged charitable trust be disregarded and the net residue of the estate be divided one half to said trust and one half to the heirs. The compromise agreement was approved by the Probate Court pursuant to the Massachusetts compromise statute (Massachusetts General Laws 1932; Chapter 204, §§15-17, set forth in an appendix) and a decree was entered on April

26, 1932 admitting the will to probate, issuing letters testamentary to the executors named therein and directing said executors "to administer the estate of said deceased in accordance with the terms of said will and said agreement of compromise" (R. 39, 40, 60).

Owing to the depression, the executors had difficulty in finding the necessary funds to discharge the pecuniary legacies, totalling approximately $300,000., which, under the terms of the compromise agreement, were entitled to priority in payment before there could be any distribution of the residue. The heirs undertook to finance half of the pecuniary legacies and the residuary legatees the other half. For their part of this financing the heirs formed a corporation known as Longyear Heirs, Inc., to which they assigned their respective interests in the estate in exchange for common stock. Preferred stock was issued to the pecuniary legatees (R. 60).

On July 26, 1933 the executors turned over to Longyear Heirs, Inc. as assignee of the petitioner, the entire distributable share of the petitioner in the residuary estate consisting of $80.17 in cash and a certificate of deposit representing 358 shares of each of three corporations owned by the decedent prior to her death (R. 60, 61).

The Commissioner valued this distributable share of the petitioner at $141,484.03 and treated the whole amount as income for the year in which it was received. The petitioner was thereupon assessed an additional $56,389.65 which he paid on October 16, 1936, together with interest of $8,696.03. Claim for refund was filed November 4, 1936, and after it was rejected, this suit was commenced November 27, 1936 (R. 4, 1).

The first affirmative defense of the amended answer "by way of set-off and recoupment" (R. 51, 52), relates to the Federal estate tax return of the estate of Mary B. Longyear. The Federal estate tax return was filed and the entire tax paid by the executors on November 22, 1932, more than four years before the complaint in this action was served (R. 90). In July 1933 the Commissioner advised the executors that the return correctly showed the tax and there was no deficiency (R. 91). The first suggestion that there was any deficiency in the estate tax on the estate of Mary B. Longyear was contained in the original answer filed in this case on March 11, 1937. When this action was commenced the three-year statute of limitation had barred any additional assessment of estate tax against the executors and the initiation of any proceeding in court for collection without assessment. §310 R. A. 1926; 44 Stat. 9, 77. Also the additional year for proceeding against the transferee by assessment only had expired. §316 R. A. 1926; 44 Stat. 9, 80.

Questions.

1. Is a distribution from a decedent's estate made to an heir by the executors pursuant to an order of the Probate Court, following the compromise of a will contest, exempt from taxation under Section 22(b) (3) of the Revenue Act of 1932, 47 Stat. 169, 178, which excludes from gross income "The value of property acquired by gift, bequest, devise or inheritance * * *"?

2. Is such a distribution income under the applicable Revenue Act and under the Sixteenth Amendment to the Federal Constitution?

3. Where the taxpayer is prosecuting a litigation which, if carried through to a decree in his favor, would not be productive of taxable income, does the compromise of such a litigation render the proceeds taxable income?

4. If such distribution is not subject to income tax, may the Collector set-off against the taxpayer's claim for refund of income tax collected on the same, a claim for additional estate tax against the taxpayer as distributee of the estate's assets, where no such additional tax liability was asserted against the executors or any other person within the applicable period of limitation?

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

(1) In holding that the property received by the petitioner from the executors of his grandmother's estate was taxable income under the applicable Revenue Act and under the Sixteenth Amendment of the Constitution of the United States.

(2) In holding that such property was not exempt from taxation under Section 22(b) (3) of the Revenue Act of 1932 which exempts "The value of property acquired by gift, bequest, devise, or inheritance * * *"

(3) In holding that the compromise of the pending litigation constituted a sale or exchange of property.

(4) In holding that the compromise of the pending litigation which if successfully prosecuted to judgment would not have been productive of income, rendered property received under that compromise taxable as income.

(5) In holding that the right to participate as an heir in the decedent's estate, which the petitioner

gave up under the compromise agreement, was not acquired by inheritance.

(6) In holding that the right to participate as an heir in the decedent's estate, which the petitioner gave up under the compromise agreement, had no cost basis to the petitioner.

(7) In holding that the determination of the Federal courts, as to whether the property received by the petitioner was "acquired by * * * inheritance" within the meaning of the exemption provision of the applicable revenue act, is controlled by decisions of the Massachusetts state courts construing the state inheritance tax act.

Summary of Argument.

I. Petitioner was an heir of his grandmother and it was solely by virtue of the Massachusetts statute of inheritance that he received *any* property from his grandmother's estate. The *amount* of the property received was determined by the compromise agreement which was made effective by the compromise statute. The Probate Court directed transfer of one-half the residuary estate to the heirs who were not entitled to it under the will but who would be entitled to inherit if there were no will. Therefore it must be an inheritance. Section 22(b) (3) of the Revenue Act should be construed to include every transfer of property at death by every statutory method or general rule of law.

II. The rule of the Massachusetts state courts that the state inheritance tax shall be levied upon the estate created by the will unaffected by the compromise agreement is based on a fictional devolution of property and is not binding on the Federal courts in determining whether the property received by the

petitioner constituted income. The Massachusetts decisions do not touch upon the question whether the property was acquired by inheritance.

III. The proceeds of a claim in litigation which would not be income if the claim were prosecuted to judgment, cannot be transformed into income by a compromise.

IV. The property received by petitioner was not income under the applicable Revenue Act and the Sixteenth Amendment because:

A. Petitioner derived no gain from his capital, from his labor or from both combined. Petitioner was not investing his capital; he was suing to get it. Obviously the property received was not the result of petitioner's labor.

B. A compromise is not a sale, conversion or exchange of capital assets. The contention that petitioner and the other heirs had only a right to contest probate which they exchanged for one-half the residuary estate, involves an assumption that the residuary legatees had title to the residuary estate. There is at least as much presumption in favor of the heirs as in favor of the residuary legatees. This is a case of conflicting claims to the residuary estate. The parties did not exchange these conflicting claims. Each accepted one-half in satisfaction of the claim to the whole.

The theory that a compromise is a sale or exchange is not only logically untenable, but the practical results are absurd. Under such a theory the taxpayer has only the right to sue. This can be valued only after a trial, at least in part, of the controversy compromised. Thus the litigation which the compromise was intended to avoid, will become necessary in an income tax proceeding.

C. Even if the compromise be regarded as a sale or exchange, petitioner's chance of success was at least fifty per cent, which was the proportion received of the property claimed. The record amply shows this. The price paid on the compromise should be at least presumptive, if not conclusive evidence on this point. Otherwise, there must be a trial of the will contest to determine whether petitioner's chance of success was fifty per cent or greater.

V. The first affirmative defense alleges, hypothetically, that if there was an improper deduction in computing the estate tax on Mrs. Longyear's estate, the petitioner should not be allowed to recover. Such a pleading is frivolous and condemned by the New York authorities which are controlling under the Conformity Act.

VI. Even if a deficiency in estate tax had been properly pleaded and proved, there could be no equitable set-off or recoupment against the petitioner because the Commissioner has never allowed the overpayment of income taxes which is in litigation here. Even if he should hereafter allow it, under Sections 607 and 609 R. A. 1928 (45 Stat. 791, 874, 875) he could not credit such overpayment against a deficiency in estate taxes because any liability for such a deficiency was barred before this action was commenced.

The so-called doctrine of equitable set-off and recoupment whereby a stale claim is revived, ought not to be applied in favor of the Government because in the collection of taxes the usual procedure is reversed in that the Government collects the tax first and obtains an adjudication afterwards. In a suit for refund of taxes the Government is actually enforcing its claim, although nominally the taxpayer is plaintiff.

In any set-off, therefore, the Government is really enforcing both claims and such a doctrine could be used as an instrument of oppression completely nullifying the statutes of limitation.

It would be grossly inequitable to set-off against the petitioner, who received one-twentieth of the residuary estate, the entire alleged estate tax deficiency. The petitioner could not recover contribution from the other transferees.

Argument.

POINT I.

The property received by the petitioner was exempt from income taxation by Section 22(b) (3) of the Revenue Act of 1932 which excludes from gross income "the value of property acquired by gift, bequest, devise, or inheritance."

Petitioner was an heir of his grandmother and it was solely by virtue of the statute of inheritance that he received *any* property from his grandmother's estate. Although the *amount* of the property received by him was determined by the compromise agreement which was made effective by the Massachusetts compromise statute [Mass. G. L. (1932) Ch. 204, Secs. 13-18 (See Appendix)] nevertheless, the statute of descent and distribution was still the proximate cause of petitioner's receiving the property.

The fact that Mrs. Longyear's will was probated and filed with the compromise agreement does not prevent the conclusion that the petitioner acquired the property by inheritance. There are many instances where property passes by the law of descent and distribution although a will has been probated. Where a remainder is divested and no gift-over is

provided, on the death of the life tenant the property passes by inheritance. Where a devise or bequest violates the rule against perpetuities or the rule against suspension of the power of alienation, the property passes by inheritance, although the will is probated and the other provisions may be carried out. The general rule is that if the probate court refuses to enforce a provision of a probated will because of certain rules of law, intestacy results and the heirs inherit the property.

Likewise, if a legatee renounces a bequest even after probate of the will, then the heirs would take the property under the inheritance statute. In fact the compromise in the present case might be viewed as a renunciation of one-half of the residuary estate by the residuary legatees and unquestionably the heirs would take by inheritance.

If the probate court had power to divide the property between the heirs and the legatees in a doubtful case of testamentary capacity, much as the admiralty courts have power to divide damages in collisions at sea, then there could be no question that the property received by the heirs would be an inheritance. Actually the compromise statute of Massachusetts gives the probate court power to divide the property in a doubtful case in accordance with the provisions of a compromise agreement which the parties may enter into. The transfer to the heirs cannot be any less an inheritance because they entered into a compromise agreement consenting to take half instead of all the property to which they claimed to be entitled.

Surely the word inheritance as used in Section 22 (b) (3) cannot be limited to the case of complete intestacy, viz. where the decedent left no will whatever. We submit that it must include every transmis-

sion of property to a person who would be entitled under the statute of descent and distribution.

Although it is not necessary to sustain a reversal of this case, we contend further that Congress, in using the broad language—"acquired by gift, bequest, devise or inheritance,"—intended to exclude from income taxation property transferred from a decedent by every statutory method or general rule of law in effect in each of the states. The word "inheritance" in a Federal tax statute should have a broad, national significance, and not be limited solely to the operation of the particular state statute of descent and distribution, operative where there is no will.

There are many rules of law by which property may be transmitted from a decedent, some of which are as follows: (1) the laws of descent and distribution if no will is probated; (2) the law permitting the probate of a will with the requirements as to testamentary capacity, absence of undue influence, etc.; (3) the law permitting distribution of the estate where there is a contest in accordance with a compromise agreement approved by the court; (4) the law relating to dower and curtesy; (5) the law relating to election by a surviving spouse to take his or her intestate share against the will; (6) the law relating to renunciation of legacies, and (7) the law directing the disposition of the excess above the statutory limit of a bequest to charity.

We submit that, whichever of these laws may govern, any distribution of an estate by executors or administrators pursuant to the decree of a probate

court is within the exemption intended by Congress in Section 22(b) (3).

Suppose a New York resident bequeathed his property in trust for the benefit of his wife for life, under such circumstances as would not defeat an election, with remainder to a stranger, and suppose the wife elected to take half the husband's estate, there being no children. Upon the election the probate court would direct distribution of the property, one-half outright to the wife and one-half outright immediately to the remainderman. N. Y. Decedent Estate Law, §18; *Matter of Curley,* 160 Misc. (N. Y.) 844, 290 N. Y. Supp. 822 (1936); *Matter of Mancinelli,* 158 Misc. (N. Y.) 605, 286 N. Y. Supp. 122 (1936). Neither the wife nor the remainderman would take under the will. The remainderman would get something very different from the legacy under the will; instead of a remainder interest in the whole, he would get a present fee interest in one-half of the estate. The wife would take under the law of descent and distribution, but the remainderman would not because he is not an heir of the testator. Technically the property received by the remainderman is not an inheritance, nor is it a devise or bequest; but, clearly, it could not be subject to income taxes because it is actually a devolution of property pursuant to the order of the probate court distributing a decedent's estate. Our case is much more nearly an inheritance than the property received by the remainderman in the case supposed, because petitioner was an heir of the decedent.

In any event, where a probate court directs transfer of a decedent's property to a person not entitled to it under a will, but who would be entitled to inherit if there were no will, we submit that the property is acquired by inheritance.

POINT II.

The rule of the Massachusetts state courts that the Massachusetts inheritance tax shall be levied upon the estate created by the will, unaffected by the compromise agreement, has no bearing on the question whether the property received by the petitioner was within the exemption of Section 22(b) (3) of the Revenue Act of 1932.

The majority opinion of the court below in holding that petitioner acquired no rights by inheritance relied upon the rule of the Massachusetts courts that an agreement compromising a will contest or a suit for construction of a will is not a modification of the will and the rights of the parties thereto are not testamentary in character. The cases cited and quoted from in that opinion are all dicta on this point except *Baxter* v. *Treasurer*, 209 Mass. 459 (1911). In that case the Massachusetts inheritance tax statute imposed a tax on all property "which shall pass by will or by the laws regulating intestate succession." The court held that the amount of the tax should be determined in accordance with the provisions of the will as written, without reference to the compromise agreement. The following language (p. 463) shows the reasoning of the court:

> "It is important that in the assessment of this tax there should be a plain, simple rule. The property upon which the tax is to be assessed is that which passes by will or by the laws regulating intestate succession. When there is a will, whether or not it disposes of the whole estate of the testator, whatever does pass by it passes to the legatees therein named, and by force of the will passes to no other person.

> In view of the nature and office of the compromise statute, and of the language of the tax statute, the most reasonable interpretation of the phrase 'which shall pass by will' in the tax statute is that it describes only property that passes by the terms of the will as written and not as changed by any agreement for compromise made within or without the statute."

The court's reasoning was confined entirely to the words of the statute "which shall pass by will" and apparently it was not argued and the court did not consider, whether the property received by the heir at law passed "by the laws regulating intestate succession".

Thus the Massachusetts court did not even consider the contention we are making here. We contend, not that the Longyear heirs took under the will, but that they took by inheritance, within the ambit of the exemption in a Federal tax statute. §22(b) (3) R. A. 1932. It seems idle to speculate whether the will was "amended" or whether the property "passed by will", or by the compromise agreement. Actually the residuary estate "passed" by the order of the Probate Court, one half to the heirs of the decedent and one half to the residuary legatees.

In the case at bar the compromise agreement could just as well have provided that probate be denied and the residuary estate divided equally between the heirs and the residuary legatees by an administrator to be appointed by the Probate Court. Presumably under the Massachusetts doctrine the inheritance tax would have then been imposed as though the entire residuary estate had gone to the heirs and no exemption would have been allowed to the residuary legatees for the half they actually received. Likewise, presumably the court below would have assessed no in-

come tax against the heirs, but the residuary legatees would have been liable for an income tax had they not been charitable trustees. This illustrates the absurdity of a doctrine which looks solely to the form or machinery by which the compromise agreement is carried out and ignores the actual result of the agreement.

The *Baxter* case really held that the Massachusetts inheritance tax statute taxed a fictional devolution of property which never actually occurred. Therefore the case is not even an authority against our contention that the transfer by Mrs. Longyear's executors to the petitioner was an inheritance or devolution expressly exempted by the income tax statute. Clearly it has no bearing on the broad question whether the property received by the petitioner was income.

The following states have adopted the rule of the *Baxter* case in respect to inheritance taxes: New York (*Matter of Cook*, 187 N. Y. 253, 1907); Kentucky (*Cochran's Exr.* v. *Commonwealth*, 241 Ky. 656, 44 S. W. (2d) 603, 1931); Virginia (*Lynchburg Trust & Sav. Bank* v. *Commonwealth*, 162 Va. 73, 173 S. E. 548, 1934); Arizona (*MacKenzie* v. *Wright*, 31 Ariz. 272, 252 Pac. 521, 1927); California (*In re Rossi's Estate*, 169 Cal. 148, 146 Pac. 430, 1915); Iowa (*In re Wells' Estate*, 142 Iowa 255, 120 N. W. 713, 1909), and Tennessee (*English's Estate* v. *Crenshaw*, 120 Tenn. 531, 110 S. W. 210, 1908).

The opposite rule is in effect in Pennsylvania (*Avery's Estate*, 34 Pa. St. 204, 1859; *Taber's Estate*, 257 Pa. St. 81, 101 Atl. 471, 1917); Rhode Island (*Barber* v. *Westcott*, 21 R. I. 355, 43 Atl. 844, 1899; *Codman* v. *Commissioner*, 50 Fed. (2d) 763, C. C. A.

1, 1931); Georgia (*Taylor* v. *Georgia*, 40 Ga. Appl. 295, 149 S. E. 321, 1929); Minnesota (*Estate of Thorson*, 150 Minn. 464, 185 N. W. 508, 1921), and Colorado (*People* v. *Rice*, 40 Colo. 508, 91 Pac. 33, 1907).

This conflict among the state courts has no bearing on property rights. The Massachusetts group impose the inheritance upon a fictitious devolution; the Pennsylvania group impose the inheritance tax on the estates actually received. Where there is such a conflict among state decisions, this Court has repeatedly held that the Federal revenue law must be uniform in application, and not subject to shifting standards of local jurisdictions. *Burnet* v. *Harmel*, 287 U. S. 103 (1932); *Burk-Waggoner Oil Assn.* v. *Hopkins*, 269 U. S. 110 (1925); *Weiss* v. *Wiener*, 279 U. S. 333 (1929). See *Biddle* v. *Commissioner*, 302 U. S. 573 (1938).

State decisions fixing title and legal rights to property are controlling upon the Federal courts. But state decisions defining the character of ownership of property, the method of devolution of a decedent's estate, or determining whether property received is income or capital, and generally decisions respecting the administration of state tax laws, must be disregarded by the Federal courts in the administration of the Federal revenue laws.

In *Tyler* v. *U. S.*, 281 U. S. 497 (1930), the rules of the state courts of Maryland and Pennsylvania respecting tenancies by the entirety were disregarded and it was held that the whole of the property held by the decedent by the entirety should be included in the gross estate in computing the estate tax. The following language of the Court's opinion seems particularly pertinent, page 503:

> "According to the amiable fiction of the common law, adhered to in Pennsylvania and Mary-

land, husband and wife are but one person, and the point made is, that by the death of one party to this unit no interest in property held by them as tenants by the entirety passes to the other. This view, when applied to a taxing act, seems quite unsubstantial.

"The power of taxation is a fundamental and imperious necessity of all government, not to be restricted by mere legal fictions. Whether that power has been properly exercised in the present instance must be determined by the actual results brought about by the death, rather than by a consideration of the artificial rules which delimit the title, rights and powers of tenants by the entirety at common law."

See also *Helvering* v. *Bowers*, 303 U. S. 618 (1938); and *Foster* v. *Commissioner*, 303 U. S. 618 (1938); *per curiam* decisions upon the authority of *Tyler* v. *U. S.*, *supra*.

In *Burnet* v. *Harmel*, 287 U. S. 103 (1932) an oil and gas lease was treated by Texas law as a present sale of oil and gas in place; nevertheless, this Court held that cash received was taxable as ordinary income and not a capital gain. The following sentence from the opinion, p. 110, epitomizes the law:

"The state law creates legal interests but the federal statute determines when and how they shall be taxed."

Other decisions of this Court have settled this principle beyond question. *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509 (1921); *Irwin* v. *Gavit*, 268 U. S. 161 (1925); *Helvering* v. *Butterworth*, 290 U. S. 365, 370 (No. 77 *Pardee* case—1933); *Bankers Pocahontas Coal Co.* v. *Burnet*, 287 U. S. 308. (1932); *Burk-Waggoner Oil Assn.* v. *Hopkins*, 269 U. S. 110 (1925).

Applying this principle to the case at bar, the decree of the Massachusetts Probate Court directing Mrs. Longyear's executors to transfer one half of the residuary estate to the heirs (R. 39, 40) is the decision which is controlling upon the Federal courts in administering the income tax law. That is the decree which fixes the legal and property rights of the parties. The decision in the *Baxter* case imposing the Massachusetts inheritance tax upon a fictitious devolution of property is in no way controlling upon the Federal courts and should be disregarded.

POINT III.

The determination whether property received is income depends, not on whether it was received pursuant to a compromise agreement, but on whether the rights compromised were of a sort to produce income.

If the petitioner and the other Longyear heirs had gone through with the trial of the contest and had obtained a decree denying probate, the property which they would have received would unquestionably not have been income. They would have received the whole estate by virtue of the Massachusetts statute of descent and distribution. Now, because the heirs desired to avoid the expense and publicity of a trial and executed the compromise agreement whereby they received only one-half of the residuary estate, it is claimed that the one-half they actually received is all income.

The genesis of the deficiencies against petitioner and the other Longyear heirs was *Kearney* v. *Commissioner*, 31 B. T. A. 935 (1934), which was cited with approval by the Court below. Until the decision

in the *Kearney* case, it had been well established both in the courts and in the Board of Tax Appeals that the determination of whether property received under a compromise is income or not depends, not on whether it was received pursuant to a compromise agreement, but on whether the underlying rights compromised were of a sort to produce income.

In *Farmers' and Merchants' Bank of Catlettsburg, Ky.*, v. *Commissioner*, 59 Fed. (2d) 912 (C. C. A. 6, 1932), the bank brought suit for injury to its reputation and compromised. The Court held that the sum received under the compromise was not income. The following language from the opinion shows that the Court did not consider that the existence of the compromise agreement had any bearing on whether the amount received thereunder was income (pp. 913-4):

> "The fund involved must be considered in the light of the claim from which it was realized and which is reflected in the petition filed in its action against the Reserve Bank. * * *
>
> "We think that, if petitioner's case had proceeded to a verdict, the law would not have awarded to it what it might have expected to gain but only that which it had actually lost. We are not justified in reading an element into the compromise which was not therein distinctly recognized in fact and would not have been recognized in law. We think therefore that there is no logical basis upon which petitioner could be charged with gain."

In *Strother* v. *Commissioner*, 55 Fed. (2d) 626 (C. C. A. 4, 1932), the owner of the fee of a coal mine brought suit to recover the value of coal extracted by a trespasser and compromised the suit. The Court held that compensation for damage to the mine was not income and disregarded the fact that such compensation was obtained by compromise.

In *Central R. R. of N. J.* v. *Commissioner*, 79 Fed. (2d) 697 (C. C. A. 3, 1935), the railroad brought suit against an officer to recover secret profits and received a large sum in settlement of the action. The Circuit Court of Appeals for the third circuit reversed the Board of Tax Appeals, and held that the money received by the railroad under the compromise agreement was not income. Neither the Board nor the Court considered that the fact that the money was obtained under a compromise agreement had any bearing on the question whether or not it was income. Each analyzed the claim and considered the question as though judgment had been recovered in the suit.

So too the payment to the Chicago & Northwestern Railway of $6,500,000 for undermaintenance during Federal control, which was held to be not taxable income but principal in the case of *Chicago & N. W. Ry. Co.* v. *Commissioner*, 66 F. 2nd 61 (C. C. A. 7, 1933), was a lump sum paid in compromise of much larger claims.

Alimony is not income (*Gould* v. *Gould*, 245 U. S. 151, 1917), and accordingly amounts paid in settlement of or in lieu of alimony, where there is no specific award of alimony in the divorce decree, have been held not to be income. *Jane B. Coates*, 3 B. T. A. 429 (1926); *May R. Spencer*, 20 B. T. A. 58, 66 (1930); *Douglas* v. *Willcuts*, 296 U. S. 1, 8 (1935); G. C. M. 13308, C. B. XIII-2, p. 184 (1934); *Maud H. Bush*, 33 B. T. A. 628 (1935); *Princess Lida of Thurn and Taxis*, 37 B. T. A. 41 (1938).

In *Sol Op.* 132, I-1 C. B. 92 (1922), the Solicitor of the Bureau held that the amount received in compromise of claims for damages for physical injuries and defamation of character, for alienation of affections and for surrender of the right to custody of a

minor child, were not income. The following quotation from this opinion is pertinent:

> "Nor is there a material distinction between payment under an agreement of the parties and payment pursuant to a judgment of a court" (p. 93).

The decision below was in conflict with a prior decision of the Circuit Court of Appeals for the Fourth Circuit (*Magruder* v. *Segebade*, 94 Fed. (2nd) 177, 1938) and such conflict was one of the reasons for the granting of certiorari in this case. In *Magruder* v. *Segebade* a threatened will contest was compromised by the legatees (charities) paying cash to the heirs (and residuary legatees under a prior will), but there was no approval by the Probate or other Court. The heirs brought suit against the Collector for refund of income taxes paid on that receipt of cash. The Circuit Court of Appeals for the Fourth Circuit affirmed a judgment for the taxpayers, citing the decision of District Judge Coxe in the present case with approval. The Circuit Court of Appeals for the Fourth Circuit did not decide whether the receipt was an inheritance, but held that it was not income under the Sixteenth Amendment and particularly the Court adopted the principle enunciated by the authorities cited in this Point that the compromise of a claim does not render the proceeds taxable income if a judgment on the claim would not have produced taxable income. The Court said:

> "The results of a compromise of rights, the proceeds of which rights are not taxable, do not become taxable because the compromise was brought about by an agreement not to litigate" (p. 179).

POINT IV.

The property received by the petitioner from the executors was not income under the applicable Revenue Act or under the Sixteenth Amendment of the Federal Constitution.

The term "income" has been defined by this Court in numerous decisions, as follows:

> "'Income may be defined as the gain derived from capital, from labor, or from both combined', provided it be understood to include profit gained through a sale or conversion of capital assets, * * *". *Eisner* v. *Macomber*, 252 U. S. 189, 207 (1920).

This definition is applied by all courts of the United States and the Board of Tax Appeals; and, as stated by this Court in *Bowers* v. *Kerbaugh-Empire Company*, 271 U. S. 170, 174 (1926), "That definition has been adhered to and applied repeatedly."

Applying this definition to the present case:

A. Petitioner derived no gain from his capital, from his labor, or from both combined.

Petitioner was not investing his capital; he was suing to get it. The amount received under the compromise was not an investment, but a *realization* of the property inherited from his grandmother. It was just as much a realization as if he had recovered his share of her whole estate after a successful contest of the will and a decree denying probate.

Likewise, petitioner, then sixteen years old, did not derive a gain from his labor. Whatever labor his attorneys put into the preparation of the will contest and the negotiations resulting in the compromise, did not produce a gain to him, but merely resulted in

realization of the property inherited from his grandmother.

In *Merriman* v. *Commissioner*, 55 Fed. (2d) 879 (C. C. A. 1, 1931), it was held that a will contest is not a transaction entered into for profit and that attorneys' fees and expenses paid by an unsuccessful contestant are not deductible losses. The Court said (p. 880):

> "When the petitioner brought her suit to break her aunt's will, it was to establish her right to what she must have believed honestly belonged to her. * * * If the litigation had proved successful, she would have received only such part of the testator's estate as justly belonged to her. That would not have been profit, * * * To hold that the expenses of litigation under the existing facts were a deductible loss because incurred in a transaction entered into for profit would be straining the meaning of 'profit' beyond any ordinary or usual meaning of the word and beyond the sense in which it was used by Congress."

If a transaction cannot be productive of income for the purpose of deducting expenses, surely it must be likewise unproductive of income when it is a question of how to treat the avails.

B. A compromise is not a sale, conversion, or exchange of capital assets which can be productive of taxable income.

The heirs of Mrs. Longyear, including the petitioner, if they had any property right respecting her estate, had the right either to the whole estate or to the whole residuary estate. On the other hand, the residuary legatees, if they had any property right, had the right to the whole residuary estate. Thus, disregarding the pecuniary legacies, there were mutually exclusive claims to ownership of the residuary estate.

The compromise agreement which divided the residuary estate equally cannot be regarded as a sale, conversion or exchange of assets, unless it be assumed that either the heirs collectively or the residuary legatees collectively owned the residuary estate. Before the residuary legatees could transfer or exchange half of the residuary estate to the heirs, the residuary legatees must first own it. The conception of the compromise as a sale, conversion or exchange necessarily involves a prejudging of the controversy.

Actually the heirs collectively and the residuary legatees collectively each had a claim to the entire residuary estate. It makes no difference whether it is called a claim or a right to litigate. Obviously the heirs did not transfer to the residuary legatees the heirs' claim or right to litigate, nor was the reciprocal transfer possible, because neither party wanted the other's claim or right to litigate. It cannot be assumed that either party had title to the residuary estate without deciding the merits of the controversy. What actually happened under the compromise agreement was that the heirs and the residuary legatees each collectively accepted one-half of the residuary estate in satisfaction of their claim to the whole.

A compromise, especially of conflicting claims to property, is in its nature a satisfaction and not a sale, conversion or exchange of assets. In the case at bar this is particularly clear for there was no semblance of a sale or transfer of money or property between the heirs and the residuary legatees. The executors transferred one-half of the residuary estate to the heirs and the other half to the residuary legatees.

The Circuit Court of Appeals for the District of Columbia held that the compromise of notes for less than their face value resulted in an ordinary loss and

not a capital loss from the sale or exchange of property; *Hale* v. *Helvering*, 85 Fed. (2d) 819 (1936). The following quotation from the opinion shows the court's reasoning (pp. 821-822):

> "There was no acquisition of property by the debtor, no transfer of property to him. Neither business men nor lawyers call the compromise of a note a sale to the maker. In point of law and in legal parlance property in the notes as capital assets was extinguished, not sold. In business parlance the transaction was a settlement and the notes were turned over to the maker, not sold to him. * * * If the full satisfaction of an obligation does not constitute a sale or exchange, neither does partial satisfaction."

So in the case at bar the mutually exclusive claims to the entire residuary estate were not exchanged or sold; they were extinguished or satisfied by the acceptance of one-half the property claimed.

Warner v. *Walsh*, 15 Fed. (2d) 367 (C. C. A. 2, 1926), established a doctrine that the acceptance by a widow of a life interest under her husband's will was an exchange of her dower interest for such life interest and that income payments made to her by the trustee under the will were not taxable income to her until she had received the value of her dower interest. This doctrine was accepted by other circuits [*United States* v. *Bolster*, 26 Fed. (2d) 760 (C. C. A. 1, 1928); *Allen* v. *Brandeis*, 29 Fed. (2d) 363 (C. C. A. 8, 1928)] and was generally accepted by the Commissioner until it was rejected by this Court in *Helvering* v. *Butterworth*, 290 U. S. 365 (1933). We submit that there is much more reason for treating the widow's election as a sale or exchange than for the theory of the court below that a compromise is a sale, conversion or exchange of assets.

Conceived of as a satisfaction, the determination whether a compromise produces taxable income depends solely on the nature of the claim satisfied, as is set forth in Point III. If collection of a judgment on the claim would not produce taxable income, no gain would result from satisfaction of the claim by way of compromise.

The court below prejudged the controversy by holding that the heirs had no title or claim to the residuary estate, but had merely a right to contest probate which they exchanged for one-half of the residuary estate. There is no more reason for such a holding than there is for presuming that the residuary legatees had no title, but had merely the right to offer the will for probate and endeavor to prove its validity. The Massachusetts Supreme Court has stated:

> "It is obvious enough that no one has any presently ascertained property right in assets which may be affected by a will not yet proved." *Reed* v. *Home National Bank of Brockton*, 1937 Mass. Adv. Sheets, 639, 640, 8 N. E. (2nd) 601, 602.

The ownership of the property depended on the answer to two questions of fact, (1) as to Mrs. Longyear's testamentary capacity, and (2) as to her freedom from undue influence, and on the answer to two questions of law relating to the validity of the residuary bequest. If the answer to *any one* of these four questions should have been favorable to the heirs, their property right in the entire residuary estate would have been established. On the other hand, to establish that the residuary estate belonged to the residuary legatees the answer to *all* of the four questions would have had to be favorable to them; the residuary legatees would have had to win, not only the

will contest, but also a suit to test the validity of the residuary bequest.

Aside from the fact that the conception of a compromise as a sale or exchange is impossible unless there is a decision or presumption as to the validity of the claim compromised, there is a practical difficulty in the application of such a doctrine. There must always be the assumption that the taxpayer had only a right to sue which he exchanged for the money or property received under the compromise. The value of the right to sue depends on the taxpayer's chance of success in the litigation. A court could not measure that chance accurately without hearing the evidence, especially if questions of fact are involved as in the case at bar. In other words determination of the value of the taxpayer's right to sue will require a trial, at least in part, of the litigation compromised. Thus litigants who compromise lawsuits in the expectation of saving the time and expense of litigation will be disappointed because they may have to try out the merits of the controversy with the Commissioner of Internal Revenue in an income tax case in order to establish that their chance of success was at least as valuable as the amount received under the compromise. Unless the decision below is reversed, the effect will be to compel the litigation which the compromise was intended to avoid.

The effect of the decision below is not limited to compromises of will contests. The compromise of any claim which if successfully prosecuted to judgment would not produce taxable income, would impose income tax liability upon at least one party and possibly both parties. Compromises of claims for death or personal injury, damage to property,

defamation of character, seduction, alimony and of all claims of a capital nature would come within the purview of the decision below. Few litigants of such claims will dare to compromise because of the hazard of incurring huge income taxes. Thus, if the decision below is not reversed, the well-established public policy of the courts to encourage compromises and reduce litigation will largely disappear.

C. Even if the compromise agreement be regarded as a sale, conversion or exchange of assets, petitioner realized no profit therefrom.

The majority opinion below reasoned that the petitioner acquired a status as a putative heir of his grandmother before her death, which cost him nothing; that upon his grandmother's death, after his mother's death, that status ripened into a right to contest his grandmother's will and still had no cost basis; and that upon exchange or relinquishment of that right to contest, the entire property received under the compromise was gain (R. 126, 127).

This reasoning completely ignores the fact that whatever right or claim to participate in the residuary estate the petitioner may have transferred or relinquished in the compromise, could not have been acquired otherwise than by inheritance. Death of the testatrix and the Massachusetts inheritance statute were the only sources of petitioner's claim to any participation in the estate. Entirely apart from the question whether, under Massachusetts law, the heirs acquired the property which they actually received by purchase or by inheritance (discussed under Point II), the petitioner's claim to any participation in the residuary estate prior to the execution of the compromise agreement, was based wholly on the fact that he was an heir of Mrs. Longyear. The applicable Rev-

enue Act provides that the basis for personal property received by inheritance shall be its value at date of distribution. R. A. 1932, §113 (a) (5), 47 Stat. 169, 199. Since substantially all of Mrs. Longyear's residuary estate consisted of personal property, its basis must have been its value on the date the heirs received it from the executors. Therefore, the basis value and the value realized would be determined as of the same date. There can thus be no profit to the petitioner unless the heirs' chance of success on the will contest is evaluated at less than the percentage received in settlement. Judge Hand concurred in the decision below solely because the petitioner had failed to sustain the burden in this respect.

Short of introducing the evidence which would have been introduced at the trial of the contest and actually trying the issues involved, it would have been impossible for the petitioner to have gone further in establishing that the heirs' chance of success was at least 50%. Under Massachusetts law the probate court in granting the contestants' motion to frame jury issues must have found that there was a "genuine question of fact supported by evidence of such substantial nature as to afford ground for reasonable expectation of a result favorable to the party requesting the framing of issues." *Smith* v. *Patterson*, 286 Mass. 356, 190 N. E. 536 (1934); *Briggs* v. *Weston*, 1936 Mass. Adv. Sheets 1161, 2 N. E. (2d) 466 (1936). (R. 57). Even if the will had been admitted to probate, the heirs would have contended that the residuary bequest was invalid upon two legal grounds: (1) that the residuary bequest violated the statute of wills in that Mrs. Longyear reserved to herself the right to alter or amend the trust which was to receive the residue, by an act not testamentary in character, and (2) that the residuary bequest was void as a charitable or religious bequest because its purpose was not

to promote the religion of Christian Science, but to preserve the records of the early life of Mary Baker Eddy (R. 58, 59). The guardian *ad litem* of the petitioner and of petitioner's brother was doubtful whether he should accept the settlement, largely because he felt that even if the heirs should lose the contest there was an excellent chance that the residuary bequest would be held invalid on one or both of these grounds (R. 58, 59).

There is no evidence in the record in this case indicating the strength of the proponents' case on the issues of testamentary capacity and undue influence. It is a matter of common knowledge that where a testatrix has cut off her children by a will the children have an excellent chance before a jury in a contest of the will.

The best evidence of the value of the heirs' chance of success is the amount paid in settlement. In practically every other case the price paid upon a *bona fide* transaction is regarded as practically controlling in a valuation of the property sold. Nevertheless, in the present case Judge Hand in effect held that the compromise was not *bona fide* and, therefore, that the price paid for the alleged "exchange" was insufficient evidence of its value to constitute a cost basis to petitioner. He said:

> "On the record before us it is quite impossible to say whether the bequest for the benefit of the Longyear Foundation was reduced under the agreement because of the legal strength of the contestant's position or because of avoidance by the Foundation of the expense and annoyance of litigation, or of its belief that to retain so large a portion of the estate against the protest of the relatives as would pass to it under the literal terms of the will would be unwise as a matter of

policy. That many considerations other than the weighing of strict legal rights dictate the settlement of will contests is notorious" (R. 130). There is no evidence in the record to justify any such finding or conclusion. Clearly the doctrine of judicial notice should not extend to the mental processes of officers of a charitable institution in determining whether to accept a compromise or prosecute a litigation respecting the validity of a will containing a bequest for the benefit of such charity. Furthermore under Section 17 of the Massachusetts Compromise Statute (see Appendix) the Probate Court must have approved the reasonableness of the compromise with respect to the charitable residuary legatees.

On the other hand, the record shows that the principal consideration of the four living children in accepting the compromise was the avoidance of publicity and unpleasantness of a trial (R. 59).

We respectfully submit that an attempt to speculate upon the motives which induced parties to enter into a compromise agreement, in order to evaluate the chances of success of one of the parties to the dispute at some figure different from the amount paid by the other party, will result in confusion and possibly chaos in business transactions.

Even if a compromise be deemed to be a sale, conversion or exchange of assets, neither party should be deemed to have realized gain or loss unless there was no real dispute and the compromise was collusive. In *Sterling* v. *Commissioner*, 93 Fed. (2nd) 304 (C. C. A. 2, 1937) which was decided by the Court below shortly before the decision in this case and which was largely the basis of the decision in this case, the alleged dispute compromised was actually not a dispute at all. A title company had raised a

question whether a remainder was vested or contingent. The remainder was unquestionably vested and the Court below decided that Mrs. Sterling (the taxpayer) had no color of claim, and therefore the entire amount received by her under the compromise was income. Without conceding the correctness of the *Sterling* case, we submit that it is distinguishable from our case in that here there was a real dispute involving questions of fact with litigation pending; whereas in the *Sterling* case the dispute compromised involved only a question of law as to which there could really be no doubt.

The amount paid under a *bona fide* compromise of a real dispute ought to be, at least presumptive, if not conclusive, evidence of the valuation of the chances of success of the respective parties to the litigation.

POINT V.

The first affirmative defense "by way of set-off and recoupment" is insufficient.

The second affirmative defense was abandoned by the District Attorney in the court below.

The first affirmative defense (R. 51, 52) alleges in substance that, if the value of the property received by the petitioner under the compromise agreement had not been deducted from Mrs. Longyear's gross estate in computing the estate tax, the estate tax would have been increased in an amount not less than the deficiency in income taxes paid by the petitioner and sought to be recovered in this action; that, if the value of such property "was not a proper deduction from the gross estate for the purpose of the estate tax", petitioner, as transferee and distributee, owed the United States more than he is seeking to recover from the collector in this action (R. 52).

The collector does not allege that any deficiency in the estate tax is due and owing from the petitioner; but, in effect, he alleges that if a mistake was made in computing the estate tax, petitioner equitably should not recover in this action. Such a hypothetical form of pleading is frivolous and is condemned by the New York authorities which, by the Conformity Act (17 Stat. 197), are controlling upon the Federal courts. *Stroock Plush Co.* v. *Talcott*, 129 App. Div. (N. Y.) 14, 113 N. Y. Supp. 214 (1908); *Goodman* v. *Robb*, 41 Hun (N. Y.) 605 (1886); *Stevenson & Co.* v. *Victor*, 182 N. Y. Supp. 88 (1920); *Arthur* v. *Brooks*, 14 Barbour (N. Y.) 533 (1853); *Saleeby* v. *Central R. R. of N. J.*, 40 Misc. (N. Y.) 269, 81 N. Y. Supp. 903 (1903).

POINT VI.

The collector could not by any pleading or proof defeat petitioner's recovery under the so-called equitable doctrine of "set-off and recoupment".

The collector's original answer containing a "set-off and recoupment" and petitioner's reply thereto were incorporated in the record (R. 41-48) by the District Attorney although, presumably, both were superseded by the filing of the collector's amended answer. In that original answer the collector alleges that when the plaintiff paid the deficiency in income taxes assessed against him "there was due and owing from the estate to the United States a Federal estate tax in excess of $65,005.68" (R. 43). This allegation was omitted in the amended answer.

The question whether the property received by the heirs should be exempted as going to the charitable

legatees under the Massachusetts doctrine established by *Baxter* v. *Treasurer, supra* (p. 14), was fully argued and briefed by the executors before the Commissioner and the Commissioner finally determined that there was no deficiency in Federal estate tax due from the estate of Mary B. Longyear (R. 102-105, 91). By an agreement between the executors and the Bureau, the legal question was determined before any consideration was given to the values of any of the property transferred to the heirs (R. 47) and the Commissioner's determination made unnecessary any consideration of values. The District Court for the Southern District of New York in this case had no jurisdiction to reverse the final determination of the Commissioner respecting the estate tax due from the executors of a Massachusetts decedent. There was a dispute as to the valuations and since the executors are not parties to this action the court below could not fairly determine the amount of any deficiency in the estate tax, even if it had had jurisdiction.

However, even if there were a deficiency in estate tax determined or determinable in this action, and even if the Commissioner should now allow an overpayment of income taxes for 1933, the Commissioner would be prohibited from crediting that overpayment against such deficiency in estate tax because any claim for estate tax against the petitioner as transferee was barred before this action was commenced. Section 607, R. A. 1928, declares that any payment of a tax after expiration of the period of limitation should be considered an overpayment and directs that it be "credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim". Section 609(a) of the same act provides that "any credit against a liability in

respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under Section 607". This Court said in *McEachern* v. *Rose*, 302 U. S. 56 (1937):

> "These provisions (§§607 and 609 R. A. 1928) preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation."

It was held in that case that there could be no credit of an overpayment before the overpayment was ascertained and allowed and if at that time the deficiency was barred any credit of the overpayment against it would be void by Section 609. In the present case the overpayment of income taxes has *never* been allowed, but is being strenuously contested in this Court. Any claim for deficiency in estate tax against the petitioner as transferee was barred before this action was commenced. Therefore the Commissioner could not now allow the overpayment of income taxes and credit it against a claim for an alleged deficiency in estate tax.

The so-called doctrine of equitable set-off and recoupment apparently originated with *Bull* v. *U. S.*, *supra*, 295 U. S. 247 (1935). In that case the Government had collected an estate tax and an income tax on the receipt of the same money. The estate tax was erroneously collected, but the taxpayer's right to recover was barred. This Court held that the Commissioner should have credited the overpayment of estate tax against the deficiency in income tax and the taxpayer was allowed to recover since refund of the estate tax was not barred at the time of the overpayment of income tax. This Court stated that in the collection of taxes the normal process of collecting

debts was reversed and the taxpayer was forced to have his claim adjudicated after payment rather than before, except in cases where administrative hearings were afforded. This Court said (p. 260):

> "But these reversals of the normal process of collecting a claim cannot obscure the fact that after all what is being accomplished is the recovery of a just debt owed the sovereign."

Thus this Court viewed the suit of the taxpayer for refund of income taxes as though it were an enforcement by the Government of its claim for taxes and the Court held that at the time the Government assessed the deficiency for income taxes and enforced payment, it should, in common honesty and equity, have credited the prior overpayment by the taxpayer of Federal estate taxes.

We believe that the effect of *McEachern* v. *Rose, supra,* is that the doctrine of the *Bull* case cannot be applied in favor of the Government in a suit by a taxpayer for refund of taxes. We submit that this conclusion is sound from a practical and equitable viewpoint. While the taxpayer in a suit for refund of taxes is nominally the plaintiff, the substance of the suit is a claim by the Government for additional taxes. When the Government asserts a set-off it actually is asserting both claims, although in the formal aspect of the suit the taxpayer appears to be asserting one claim and the Government the other. From a practical point of view this must be true because, otherwise, the doctrine of the *Bull* case would be an unfair weapon in the hands of the Government by which it could destroy the effectiveness of the statute of limitations. The taxpayer would pay a deficiency at his peril because the Government could rake up a claim barred by

the statute of limitations and set it off in the taxpayer's suit to recover a refund. In fact it could be an instrument of oppression because the Government could collect its claim barred by the statute of limitations by arbitrarily issuing a jeopardy assessment for deficiency in income taxes for some year still open, and in the suit for refund could plead that the taxpayer had not overpaid his tax bill to the United States because of the barred claim.

In the present case all of the other heirs of Mary B. Longyear, except the plaintiff's brother, have filed petitions in the Board of Tax Appeals. Obviously, the Government cannot set-off Federal estate tax liability in any of those proceedings. If set-off is allowed against this plaintiff in this proceeding, he will thereby be compelled to pay substantially the whole of the Federal estate tax solely because he paid the deficiency instead of filing a petition in the Board of Tax Appeals. Thus, the result of attempting to apply the doctrine of the *Bull* case in favor of the Government in suits for refund of taxes will be to discourage prompt payment of taxes to the Government. A taxpayer who pays his tax and sues to recover ought to be in at least as favorable a position as a taxpayer who petitions to the Board of Tax Appeals.

The collector may assert that *Stone* v. *White,* 301 U. S. 532 (1937) rather than *McEachern* v. *Rose, supra,* is applicable to this case because it would be inequitable for the petitioner to recover since he equitably owes the Government as transferee a larger amount for Federal estate tax and interest. The cases were distinguished (*McEachern* v. *Rose, supra,* pp. 62, 63) upon the ground that §§607 and 609 did not apply to crediting the amount which one taxpayer had paid against the tax which another should have paid. In

the present case the Commissioner is seeking to credit an overpayment of income taxes against an alleged claim for estate taxes against the *same* taxpayer and this is clearly prohibited under the decision in *McEachern* v. *Rose.*

To apply the equitable doctrine of *Stone* v. *White* in the present case would result in gross unfairness to the petitioner. If a claim for a deficiency in the Federal estate tax due from Mrs. Longyear's estate had been timely made, it would have been paid by the executors before the estate was distributed and the residuary legatees would have borne one-half (R. 21, 22, 23, 24, 25). Plaintiff received one-tenth of the share of the residuary estate going to the heirs under the compromise agreement and consequently would have borne one-twentieth of the Federal estate tax. If this set-off is now allowed he will be compelled to pay substantially the entire alleged deficiency in Federal estate tax. To compel petitioner to bear more than one-twentieth of any alleged estate tax deficiency would be a travesty upon equity and justice.

The collector in the court below relied upon *Phillips-Jones Corporation* v. *Parmley,* 302 U. S. 233 (1937) to establish the proposition that the petitioner would have a right of contribution against the other transferees from the estate. In that case the Commissioner assessed additional income and profits taxes against a corporation within the period of limitation, but after the corporation had liquidated and distributed its assets to its stockholders. The Commissioner assessed against one stockholder, Phillips, as transferee, the entire amount of the unpaid assessment, and collected it. Phillips sued the other stockholders for contribution. The District Court dismissed the bill and the Circuit Court of Appeals for

the Third Circuit affirmed on the ground that there had been no assessment against the other stockholders, 88 F. (2d) 958 (1937). This Court reversed and sustained Phillips' right to contribution on the ground that the assessment created a debt of the corporation which was a common burden and that to recover the plaintiff need only prove "that there was a common burden of debt and that he has, as between himself and the defendants, paid more than his fair share of the obligations" (p. 236). In *Stone* v. *White* this Court expressly negatived the idea that it was reviving a stale claim by way of set-off as is shown by the following (p. 539):

> "Here the defense is not a counter demand on petitioners, but a denial of their equitable right to undo a payment which, though effected by an erroneous procedure, has resulted in no unjust enrichment to the government, and in no injury to petitioners or their beneficiary. The government, by retaining the tax paid by the trustees, *is not reviving a stale claim.* Its defense, which inheres in the cause of action, is comparable to an equitable recoupment or diminution of petitioners' right to recover." (Italics ours.)

Therefore, in the present case if the petitioner's recovery were defeated under the doctrine of that case, he would not be paying a claim or debt of the executors of Mrs. Longyear's estate and there would be no basis for contribution against the other transferees of the estate because he would not have paid a "common burden of debt". Furthermore, the compromise agreement contained no provision for the payment by the residuary legatees of any taxes assessed after the division of the estate.

To allow the collector to set-off against one who received one-twentieth of the residuary estate sub-

stantially the entire alleged estate tax deficiency, would be shockingly inequitable and clearly not within the doctrine of *Stone* v. *White*.

LAST POINT.

The decision and order on mandate of the Circuit Court of Appeals for the Second Circuit should be reversed, and the judgment of the District Court for the Southern District of New York should be affirmed.

Respectfully submitted,

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September, 1938.

Appendix:

Massachusetts General Laws 1932, chapter 204, sections 13-18.

COMPROMISES, ETC.

SECTION 13. The probate court may authorize an executor, administrator, guardian, conservator, receiver, commissioner or other fiduciary officer appointed by it, or a trustee, to adjust by arbitration or compromise any demand in favor of or against the estate by him represented.

SECTION 14. The supreme judicial court or the probate court may authorize an executor, administrator, guardian, conservator, receiver, commissioner or other fiduciary officer appointed by the probate court, or a trustee, to adjust by arbitration or compromise any controversy or question as to the administration or distribution of the estate in his possession, or as to his accounting therefor, or as to any matter relating to said estate, or as to the construction of a will or trust created by a written instrument, or as to his power and authority thereunder, or as to any controversy growing out of said will or instrument that may arise between him and any other person or the guardian or conservator of any person interested under said will or instrument or in said estate, or between claimants or the guardians or conservators of claimants to said estate, to which arbitration or compromise, in the form of an agreement in writing, such executor, administrator, guardian, conservator, receiver, commissioner or other fiduciary officer or trustee, and all other persons in being and of full age and not under guardianship, and the guardian or conservator, if any, of all other persons

who claim a vested interest in said estate, whose interests will, in the opinion of the court, be affected by the proposed arbitration or compromise, shall be parties. An award or compromise made in writing in such a case, if found by the court to be just and reasonable in its effects upon the interests of minors and persons under guardianship or conservatorship, and upon any future contingent interests in said estate, shall, when approved by the court, be valid and binding upon all such interests and upon the original parties to said agreement, and a decree shall be entered accordingly. If the court finds that any minor or person without legal capacity or under guardianship, or any future contingent interests, may be affected, it may appoint some person or persons to represent such minor or person without legal capacity or under guardianship, or future contingent interests in such controversy, question, administration or account upon such conditions as to costs as it may order.

SECTION 15. The supreme judicial court or the probate court may authorize the persons named as executors in an instrument purporting to be the last will of a person deceased, or the petitioners for administration with such will annexed, to adjust by arbitration or compromise any controversy between the persons who claim as devisees or legatees under such will and the persons entitled to the estate of the deceased under the laws regulating the descent and distribution of intestate estates, to which arbitration or compromise the persons named as executors, or the petitioners for administration with the will annexed, as the case may be, those claiming as devisees or legatees whose interests will, in the opinion of the court be affected by the proposed arbitration or compromise, and those claiming the estate as intestate, shall be parties.

SECTION 16. If the court finds that any future contingent interests which would arise under said will if admitted to probate would be affected by the arbitration or compromise, it shall appoint some person to represent such interests in such controversy, and the court shall have like power as to any bequests made in the will for charitable purposes, if no trustees have been appointed in such will; in both cases with such conditions as to costs as the court orders.

SECTION 17. An award or compromise made in writing in any such case, if found by the court to be just and reasonable in relation to the parties in being and in its effect upon any future contingent interests that might arise under such will and upon any bequests to charities made in the same, shall be valid and binding upon such interests and upon such bequests, as well as upon the interests of all persons in being, but it shall not impair the claims of creditors.

SECTION 18. If a minor or a person under guardianship or conservatorship is a necessary party to an arbitration or compromise under section fifteen, he shall be represented in the proceedings by his guardian or conservator, or by a guardian *ad litem* appointed by the court, who shall in the name and in behalf of the party he represents, make and receive all proper conveyances and payments necessary to carry into effect any award or compromise sanctioned by the court.